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Before the
FEDERAL COMMUNICATIONS COMMISSION

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In the Matter of	)	
	)	
Implementation of Sections of the	)	MM Docket No. 93-215
Cable Television Consumer	)	
Protection and Competition Act of	)	
1992:	)	
	)	
Rate Regulation	)	
To the Commission:	)	

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

JOINT COMMENTS

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CONSOLIDATED CABLE PARTNERS, L.P.
CROWN MEDIA, INC.
MULTIVISION CABLE TV CORP.
PARCABLE, INC.
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Summary of Joint Comments

The Joint Parties commend the Commission for its recognition that cable operators must be afforded a meaningful opportunity to recover both costs and a reasonable profit where benchmark rates are inadequate to do so and for its willingness to propose and consider workable alternatives which will permit such recovery. The Joint Parties likewise welcome the Commission's observation that cost-of-service regulation for the cable industry need not and should not inflexibly embrace a traditional telephone or other utility model with all of its trappings. Having properly stated the purpose and objective of this proceeding, the Commission is most likely to achieve the desired and correct result if its cost-of-service rules produce rates which track pricing in a competitive environment and if they recognize and respect the impact caused by a transition from unregulated to regulated status.

The Joint Parties do not concur, however, with the Commission's tentative conclusion that the ratebase should be based on net original cost of the assets in question. That approach, particularly to the extent it excludes acquisition costs and accumulated losses, would contravene the well-established judicial and administrative agency principle that plant and equipment must be valued as of the time it is placed into regulated service. Moreover, to ignore such

legitimate investments and property interests would constitute an uncompensated taking and would be violative of constitutional commands. As a more appropriate and, the Joint Parties submit, legally sufficient as well as economically rational alternative, the Joint Parties propose the use of a "competitive market value" approach to ratebase valuation. This methodology would produce rates which more closely track those occurring in a competitive environment and would provide an orderly transition to rate regulated status.

After establishing the initial ratebase at the competitive market value of the assets, the Commission should, on a going-forward basis, employ a "trended original cost" methodology. This approach creates a more stable rate regulation environment by adjusting for inflation.

The Commission should also set an industry-wide uniform rate of return. As indicated in an economic analysis prepared for the Joint Parties by the Brattle Group, the appropriate rate of return for the cable industry should be based on a risk premium model and should be at the high end of the 12-16 percent range, with an additional efficiency factor of at least one percent. With respect to other cost-of-service standards, the Commission should adopt uniform depreciation standards for broad classes of assets, similar to those in place for the equipment basket, based on the economic life of the assets. Allocation and accounting rules should generally apply at the system level and should recognize the inadequacy of the concept of traditional channels in a digital environment. Above all, accounting requirements must be characterized by ease of administration and application.

Finally, the Joint Parties urge the Commission to not adopt rules governing transactions with affiliates in the absence of clear evidence of abuses, to not include a productivity offset factor in its pricecap regime and to not exclude subchapter S corporations, partnerships and individual cable system owners from recovery of federal and state income taxes as an operating expense.

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Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992:	)	MM Docket No. 93-215
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Rate Regulation	)	
To the Commission:	)	

JOINT COMMENTS

Cablevision Industries Corporation; Consolidated Cable Partners, L.P.; Crown Media, Inc.; Multivision Cable TV Corp.; ParCable, Inc.; and Providence Journal Company[1] (hereinafter "Joint Parties"), by their attorneys, hereby submit their Joint Comments in response to the Commission's request for comments on its proposals for cost-of-service regulation of cable rates.[2] Each of the Joint Parties owns and operates cable television systems and, accordingly, will be directly and substantially affected by the outcome of this proceeding.

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[1] Providence Journal Company conducts its cable television operations through its subsidiaries Colony Communications, Inc. and King Videocable Company.

[2] Notice of Proposed Rulemaking, MM Docket No. 93-215, FCC 93-353 (released July 16, 1993) ("Cost-of-Service NPRM" or "NPRM").

I. THE CABLE ACT REQUIRES THAT THE COMMISSION'S BENCHMARK APPROACH MUST BE BALANCED BY RATIONAL AND COMPENSATORY COST-OF-SERVICE STANDARDS

In directing the Commission to establish a comprehensive scheme for the regulation of cable television rates, Congress afforded the agency certain discretion and flexibility to fashion regulations to accomplish the purposes and objectives of the 1992 Cable Act.[3] Congress also chose, however, to give explicit direction and guidance to the Commission on certain fundamental elements of its regulatory program. In particular, the Act requires that, in prescribing rate regulations for basic service, the Commission "shall take into account" specifically enumerated costs incurred in the provision of basic cable service.[4] Congress did not intend, moreover, that cable operators would be limited simply to recovery of costs under the rate regulation program to be adopted by the Commission; the Act also unambiguously

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[3] Cable Television Consumer Protection and Competition Act of 1992, Pub. L. No. 102-385, 106 Stat. 1460 (1992).

[4] The Act expressly identifies each of the following costs of providing basic cable service: the direct costs and a portion of the joint and common costs attributable to providing signals on the basic tier and changes in such costs; franchise fees, taxes and other governmental assessments; and costs associated with meeting franchise requirements. Section 623(b)(2)(C)(ii, iii, v and vi).

provides that the Commission is to ensure that operators receive a reasonable profit.[5]

The Commission has begun the process of carrying out the rate regulation requirements of the Act by adoption of an initial decision which establishes the benchmark approach.[6] While benchmarks serve a useful purpose as a point of entry into comprehensive rate regulation, that usefulness is nonetheless limited and cannot, as a legal, policy or practical matter, serve as the sole form of cable rate regulation. The limitations are obvious. The Commission's benchmark scheme, which is based on a limited survey of rates in effect on September 30, 1992, takes costs into account, if at all, only indirectly and imprecisely at best.[7] Indeed, the Commission itself has observed that while the benchmarks are to be adjusted on a going forward basis to account for certain cost increases, "the starting price cap level is based on industry-wide data and does not necessarily reflect individual systems' costs of providing cable service."[8]

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[5] Section 623(b)(2)(C)(vii).

[6] Report and Order, MM Docket No. 92-266, FCC 93-177 (May 3, 1993) (hereinafter "Report and Order").

[7] Various studies associated with Petitions for Reconsideration of the Report and Order point out serious flaws int he benchmark methodology. See, e.g., Petition of Viacom International Inc.

[8] Report and Order at ¶262.

Although the Commission has stated a preference for benchmarks, it has nonetheless recognized and acknowledged the shortcomings of the benchmark/price cap approach:

> Thus, we cannot be certain that the initial capped rate defined through benchmark comparisons will permit all cable operators to fully recover the costs of providing basic tier service and to continue to attract capital. We do not believe that Congress intended that cable operators could, or should, be compelled to provide basic service tier service at rates that do not recover such costs.[9]

Additionally, the Commission confirms that rates established by cost-of-service proceedings must be set at levels which "allow cable operators to earn a reasonable profit for provision of cable service."[10] The Commission has thus placed the entire burden of meeting these statutory requirements on its cost-of-service standards and describes the fundamental role of this proceeding as the establishment of rules and standards which will permit regulators to determine whether rates that exceed the benchmarks are nonetheless reasonable in light of a cable operator's permissible costs. Cost-of-Service NPRM at ¶¶ 7, 10.

The Commission properly reads the 1992 Cable Act, and applicable judicial precedent, as calling for a balancing of the interest of cable operators in recovering their reasonable cost, including a cost of capital, with the

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9 Id.

10 Report and Order at ¶264.

interest of consumers in reasonable rates.[11] See Cost-of-Service NPRM at ¶8. Thus, any attempt to force rates produced by the proper application of legitimate cost-of-service standards to arbitrarily low levels in order to achieve a preconceived result would deny cable operators their legally protected interest in recovering costs and attracting capital. As the Commission previously acknowledged, "We do not believe that Congress intended that cable operators could, or should, be compelled to provide basic tier service at rates that do not recover such costs." Report and Order at ¶262.

Tipping this balance in order to reduce cable rates to artificially low levels is contrary not only to the Act itself, but to the interests of consumers as well. Congress and the Commission intend that consumers will benefit by lower rates; but consumers will not benefit if cable operators are unable to cover their costs and attract capital. Operators would simply be unable to sustain their existing level of service, much less continue to provide an ever greater quantity and quality of cable service. As the Commission acknowledged, "[A]n overly tight cap on rates could hinder cable operators' ability to make network

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[11] The balancing of interests of the regulated entity and those of ratepayers is well recognized by established case law. See, e.g., FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944). The regulatory agency is thus not free to tilt one way or the other.

improvements that could benefit subscribers." Report and Order at ¶262.

Furthermore, balancing of operators' and consumers' interests is essential to fulfilling the Commission's goal that its "regulatory requirements for cost-based rates should also be designed to assure that cable operators may fully respond to incentives to provide a modern communications infrastructure and to respond to competitive forces." Cost-of-Service NPRM at ¶9.[12] The Commission admits that cost-of-service standards that strain to suppress cable rates could "thwart operators' ability to respond to competitive forces by means of facility and service improvements." Id.

Cost-of-service showings cannot, therefore, be constrained by result-oriented rules and standards which attempt to force rate levels down to those produced by the benchmarks and which, directly or indirectly, provide a disincentive to operators seeking to make such showings to justify legitimate costs. The Commission must not depart from its position, for both legal and policy reasons, that cost-of-service is a necessary and appropriate "backstop" to

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[12] The Commission noted that the Cable Act itself "identified the policy goal of ensuring that cable operators continue, where economically justified, to expand the telecommunications infrastructure." Id., citing, *inter alia*, Cable Act of 1992, § 2(b)(3). The Commission concurred with Congress "that cable operators can, and should, contribute to the continued development of an advanced telecommunications infrastructure." Id. at ¶ 9.

benchmarks. To the contrary, the Commission would contravene the Act, the Constitution and the public interest were it to skew its cost-of-service rules and standards in an effort to approximate benchmark rates. To do so would significantly undermine the cost-of-service alternative and would present operators with a meaningless choice.

II. THE OBJECTIVES OF THE COST-OF-SERVICE RULES SHOULD BE TO PRODUCE RATES WHICH WOULD RECOVER COSTS IN A COMPETITIVE ENVIRONMENT AND WHICH RECOGNIZE THE UNIQUE CIRCUMSTANCES OF A TRANSITION TO RATE REGULATION

The Joint Parties respectfully submit that the Commission can best accomplish the objectives of meeting statutory requirements, fulfilling important policy goals and striking a fair balance if its cost-of-service rules follow two fundamental precepts, each of which is firmly embodied in the NPRM itself. First, regulation should seek to replicate rates as they would exist in a competitive marketplace. Second, regulation must acknowledge the unique, complicating factors inherent in the industry's transition into a rate regulated environment. If the Commission can promulgate cost-of-service regulations that result in cable rates at fully competitive levels while avoiding a disruptive transition to regulation, it will have fulfilled not only its mandate under the Cable Act of 1992 but also its broader duty to serve the public interest.

A. Rates Established by Cost-of-Service Showings Should Mirror Those In A Competitive Environment

The thrust of both the Cable Act and the NPRM recognizes that rate regulation exists only to cure perceived market failures, that is, the absence of competitive forces adequate to drive rates to levels that provide for the recovery of costs and a reasonable profit, but no more. Rate regulation, and cost-of-service regulation in particular, should thus seek to replicate rates as they would exist in a competitive market.[13]

The Commission's understanding of the purpose of cost-of-service rate regulation provides an appropriate response to the question posed in the NPRM as to "what rate levels our cost-based requirements should produce in relation to benchmark rates."[14] The cost-based alternative to benchmarks is, of course, premised entirely on the need for operators to have a mechanism for justifying rates that exceed the benchmarks. If the rates produced by one of these two methods are to be adjusted, the price-based benchmarks should appropriately be corrected to match more closely the rates derived from cost-based showings if the Commission's primary

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[13] As various parties have demonstrated in Petitions for Reconsideration of the Report and Order, the benchmarks do not achieve this goal because the so-called "competitive systems" on which they are based are not in competitive equilibrium.

[14] NPRM at ¶7.

mode of regulation is to succeed in replicating competitive rate levels, defined by the Commission itself as "rates that approach the operators' cost." Cost-of-Service NPRM at ¶10.

The Commission has already correctly rejected the suggestion that cable operators not be allowed to exceed benchmark/price cap rates unless that rate would be wholly confiscatory. Report and Order at ¶263. A "confiscatory only" standard, the Commission has recognized, "would constitute a substantially stricter standard that may ultimately disserve consumers by limiting cable operators' business incentives to provide service." Id. The Commission has thus acknowledged that fulfilling its mission of establishing cost-based standards for rate regulation will replicate the competitive rate levels only if they cover costs, including the cost of capital.

B. Transitioning To The Cost-of-Service Regime Must Give Due Consideration To Existing Cable Industry Financial Practices and Structures

Establishing cost-of-service standards that replicate competition would be difficult even for an industry with a well-established history of rate regulation; the Commission's task is made substantially more difficult by the fact that this pervasive regulatory regime is being imposed on an industry whose rates, as well as financial structure in general, were previously unregulated. Other federal regulatory agencies, such as the Federal Energy Regulatory Commission, "have established a balancing of consumer and regulated company interests that explicitly recognizes a transition [from] an unregulated to a regulated environment." Cost-of-Service NPRM at n.21, citing Regulation Of Natural Gas Pipe Lines After Partial Wellhead Decontrol, Docket No. RM 87-34-065, Order No. 636, Section XI (FERC April 8, 1992). Indeed, the Commission has acknowledged the need for "explicit transition elements addressing the changes in financial practices and structure required by cable operators as they adapt to a rate regulated environment" in view of the fact that its proposed requirements "governing costs may constitute different costing, accounting, and financial practices for purposes of setting rates than current practices in the cable industry" and the fact that they may also represent "a different measure of industry performance then currently used by the cable industry and lenders." NPRM at ¶22.

The Commission has further recognized the tremendous dislocation that could result from precipitously imposing new regulatory standards that comprehensively reshape the basic financial structure of the cable industry. The Commission's rate regulation requirements will not merely burden the industry with entirely new accounting obligations; they will in all likelihood require most operators to renegotiate existing financial arrangements at best and force some operators into default and bankruptcy at worst. The real costs of capital investment and operating expenses currently borne by the cable industry and the existing obligations due to its creditors cannot be erased by regulatory fiat. The Commission states in this regard that "[a]n important determinant of the standards that we adopt will be the impact on the industry and consumers." Id. at ¶22. If cost-of-service standards leave cable operators no better off with respect to recovery of costs than do benchmarks, substantial segments of the cable industry will experience loan covenant violations and defaults and ultimately foreclosures and bankruptcies.

The foregoing considerations apply with particular force to the question posed in the NPRM as to whether operators should be limited in their ability to cost-justify existing rates by cost-of-service showings.[15] In view of the use of September 30, 1992 as the date for establishment of benchmark rate levels, the imposition of the industry-wide rate freeze on April 1, 1993 and the likelihood that this cost-of-service rulemaking will not be finally resolved for several more months, more than a year will have elapsed during which the industry will have been unable to recover newly-incurred legitimate costs. Many of the Joint Parties are engaged in

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[15] NPRM at ¶18.

on-going system rebuilds as to which they had a reasonable expectation of cost recovery through future rate increases as a result of either deregulated status or agreements with franchise authorities. The pass-throughs of certain external costs permitted by the Report and Order are limited in their scope and generally have prospective applicability and effective dates; the Commission has, at least for now, reserved judgment on the appropriate method for recovery of the cost of system improvements. Thus it would be inappropriate -- indeed improper -- for the Commission to presume that "existing" (in reality September 30, 1992) rates are fully compensatory with regard to today's costs. To the contrary, if the legal and constitutional safeguards of cost-of-service are to have any meaning, operators must be afforded the opportunity to demonstrate that existing rates are not compensatory under cost-of-service standards.

III. ESTABLISHMENT OF THE INITIAL RATEBASE MUST RESPECT LEGALLY PROTECTED PROPERTY INTERESTS AND THE PREVIOUSLY UNREGULATED STATUS OF THE CABLE INDUSTRY

Perhaps the most critical aspect of the package of cost-of-service rules which requires faithful adherence to the fundamental precepts of replicating competition and a transitioning industry is the initial establishment and valuation of the cable operator's ratebase. If this issue is mishandled, debating the remaining elements of the rate-of-return formula becomes irrelevant as it will not produce an economically viable result. It is the prior unregulated status of cable which renders the NPRM's proposed application of "original cost" methodology unsound and improper as a matter of both law and policy. An approach which attempts to replicate rates as they would exist in a competitive environment leads to a more appropriate valuation methodology: a competitive current market value concept which avoids the systematic undervaluation of cable systems which results from an historical cost calculation and avoids the potential inclusion of capitalized monopoly rents as well (see discussion beginning on page 29, *infra*.).

A. The NPRM Misapplies "Original Cost" Methodology And Its Underlying Rationale

1. The NPRM's Approach To Establishing The "Original Cost" Of Cable Systems Is Contrary To Established Public Utility Law As Applied By The FCC And Other Regulatory Agencies.

The application of "original cost" methodology as proposed by the NPRM fundamentally ignores the across-the-board transformation of cable from a non-regulated to a pervasively regulated industry. The Commission, and public utility law in general, has long defined "original cost" of plant as of the time the plant is first used in regulated service, i.e. dedicated to public use. It is the pervasive, utility-type regulation, including rate regulation in particular, mandated by the Cable Act of 1992 that is contemplated by the "dedication to public use" standard. Thus, for systems acquired prior to the impending rate regulation, the "original cost" of plant -- contrary to the NPRM's suggestion -- is the net book cost for the newly regulated cable operator, not for its predecessor.

The Commission has consistently defined "original cost" based on the cost to the owner of that plant at the time it is dedicated to regulated service. The Uniform System of Accounts ("USOA") first defined "original cost" as "the actual money cost of (or the current money value of any consideration other than money exchanged for) property at the time when it was first dedicated to the public use, whether by the [current] accounting company or by a predecessor public utility."[16] The USOA created a separate account, called the plant acquisition adjustment account, to record the difference between the amount of money or other consideration actually paid for telephone plant acquired, plus preliminary expenses incurred in connection with the acquisition, and the net original cost of the plant to the entity first dedicating it to the public use. Id. From the outset, therefore, the Commission's definition of original

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[16] See American Tel. & Tel. Co. v. United States, 299 U.S. 232, 238 (1936).

cost has recognized the inappropriateness of looking to the historical cost of plant prior to regulation. The Commission continues to this day to define original cost as the cost of the regulated property at the time of its dedication to the public use.[17]

This definition of "original cost" is also common among other federal and state utility regulators who employ this valuation methodology. The Federal Energy Regulatory Commission, for example, defines original cost as "the cost of [plant] to the person first devoting it to public service." 18 C.F.R. Part 101(23) (1992). Numerous states that also employ original cost accounting likewise define original cost as of the time that the plant in question was placed under rate regulation or otherwise dedicated to the public use.[18]

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[17] The Commission's USOA continues to define "original cost" as of "the time when it was first dedicated to use by a regulated telecommunications entity . . ." 47 C.F.R. § 32.9000 (1992) (Glossary Of Terms For The Uniform System Of Accounts).

[18] See, e.g., Hackensack Water Co. v. Borough of Old Tappan, 390 A.2d 122, 126 (N.J. 1978) ("original cost is the cost of the property to the first person who devoted the property to utility service."); Re Alaska Gas & Service Co., 18 P.U.R. 4th 1 (AK 1976) (original cost determined at the time the first person devotes the property to public service); Re Mohave Electric Co-op, Inc., 48 P.U.R. 4th 85 (Ariz. 1982) (original cost of electric cooperative's property determined when first devoted to public service); Ohio Suburban Water Co. v. Ohio Public Utilities Comm'n, 402 N.E.2d 539 (Ohio 1979) (original cost of utility property determined when first dedicated to public use); Re Heater Utilities, Inc., Docket No. W-274, Sub. 4 (N.C. Dec. 21,

Accordingly, the Commission has made perfectly clear that it will not look to the preceding owner of plant to determine "original cost" where plant first became dedicated to regulated use under its current ownership. See Rate Base And Net Income Of Dominant Carriers, 4 FCC Rcd 1697, 1703 (1989) ("original cost . . . means the actual cost of property when it was first dedicated to use by a regulated entity, whether by the current owner or by a predecessor"). The Commission also recently made clear that dedication to the public use, for purposes of determining excess acquisition costs, means the time the plant was put into regulated service. See Rate Base And Net Income Of Dominant Carriers (Remand), 69 Rad. Reg. 2d (P&F) 1567, 1568 n.3 (1991) ("a premium, or a plant acquisition adjustment, results from a carrier paying an amount for plant above that plant's net original cost at the time it was put into regulated service less depreciation reserve").

Therefore, if the Commission intends to establish the initial valuation of cable rate base pursuant to "original cost" methodology, its own established policy and utility law

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1971) (original cost of water company's equipment determined as of the time plant was first devoted to public utility use); Re Central Main Power Co., 29 P.U.R. 3d 113 (M.E. 1959) (original cost means the actual legitimate original cost of property when first devoted to public use); Arlington County v. Virginia Electric Power Co., 87 S.E.2d 139 (Va. 1955) (original cost of plant determined when first devoted to public use).

in general mandate that the original cost be established as of the date cable systems became subject to regulated operations. It is of course the 1992 Cable Act itself that has created the ongoing "transition of the [cable] industry from a non-regulated to a regulated environment." NPRM at ¶22. Indeed, the issue of rate base valuation arises, by definition, only when an industry is rate regulated and its return on investment thereby becomes a matter of public concern and governmental control. It would therefore be inappropriate to consider cable plant to have been dedicated to the public use prior to rate regulation.

Thus, for all cable systems acquired before the onset of rate regulation, "original cost" will amount to the current operator's net acquisition costs. Under such circumstances, "original cost" methodology recognizes that there are no "excess" acquisition costs. As explained by a leading commentator on public utility law:

> "In cases where used property is purchased from non-utility sellers, no acquisition adjustment is usually involved, since the property has not previously been utilized in providing utility services. In these cases, net original cost is the purchase price paid by the acquiring utility."

Accounting for Public Utilities, Charles F. Phillips, Jr. (1985) at § 4.04[3]. See, e.g., Virginia Electric and Power Co., 38 F.P.C. 487 (1967) and Black Hills' Power and Light Co., 40 F.P.C. 166 (1968) (acquisition prices of electricity plants acquired from non-utilities constituted original cost because plants had not previously been dedicated to public use).

Accordingly, the "original cost" of previously acquired cable plant could only be properly based on the net acquisition cost reflected on cable systems' books as of the date on which a particular system becomes subject to rate regulation under the 1992 Cable Act. Inasmuch as the precise date on which a particular cable system, or level of service, becomes subject to regulation may vary, the Commission may determine that a uniform date would be more appropriate. If so, the operative date should be the effective date of the Commission's rate regulation rules (September 1, 1993).

2. The Traditional Policy Rationale For Disallowance of "Excess" Acquisition Costs Does Not Apply to Transactions Prior to Rate Regulation

Cable system acquisitions that predate rate regulation and that were negotiated at arm's length in the normal course of business provide no reason to doubt that their purchase price was based upon prevailing market values. The nature of these acquisitions, therefore, simply does not give rise to the traditional concerns warranting disallowance of "excess" acquisition costs.

The original rationale for disallowing excess acquisition costs was to preclude utilities from inflating